BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

Error to Be Assigned.

The Circuit Court of Appeals erred in affirming the decision of the Board of Tax Appeals.

Argument.

1. This case involves a mixed question of fact and law.

The effect of the action of the Circuit Court in affirming the Board of Tax Appeals was to establish the rule that the stock of a bank becomes worthless upon the closing of the bank even though the appraisers do not file their report until the following year. The Board of Tax Appeals held as a fact that the stock of the Franklin Trust Company became worthless in 1931. The Circuit Court refused to reverse the Board of Tax Appeals because that court felt it was just a question of fact and therefore it lacked the power to reverse the Board's decision. But it is respectfully submitted this involves a mixed question of fact and law, and the Circuit Court did have the right to reverse the Board of Tax Appeals.

Helvering v. Rankin, 295 U. S. 123, 131;
Helvering v. Tex-Penn Co., 300 U. S. 481, 491.

One of the chief reasons advanced by the Commissioner of Internal Revenue that the stock become worthless

in 1931 was that a receiver was appointed at that time. But in Pennsylvania a receiver may be appointed for a corporation even though it is solvent: *Cunliffe v. Consumers Asso. of America,* 280 Pa. 263, 267; *Deere Plow Co. v. Hershey,* 287 Pa. 92, 99; *Schipper Bros. v. Economy Coal Co.,* 277 Pa. 356, 362; *Cowan v. Pa. Plate Glass Co.,* 184 Pa. 1, 9. The same rule was laid down by the United States Court of Claims in *Lyon v. United States,* 5 Federal Supplement 138. The court in that case said on p. 139:

> "It is generally held that the mere appointment of a receiver or even a showing of bankruptcy of a corporation is not sufficient in itself and alone to entitle a taxpayer to deduct the cost of the stock in such corporation as worthless. For all this may happen merely because the corporation is unable to meet its obligations in the ordinary course of business. . . ."

From this it is clear that the question involved here was more than just a question of fact. The determination of the assets to the liabilities as set forth in the appraiser's report which was filed the year after the bank closed was a question of fact. But the effect of the closing of the bank, and the appointment of the receiver in one year and the filing of the appraiser's report the following year was a mixed question of law and fact. This is all the more true when it is considered that from the time the bank closed until the appraiser's report was filed efforts were being made to reopen the bank. The decedent taxpayer himself was very active in these efforts. Moreover the Secretary of Banking took possession of this bank, not of his own initiative, but at the request of the officers of the bank. This request was made to prevent three depositors from withdrawing $1,000,000 at one time. The bank had borrowed the

$1,000,000 to make itself more liquid and when three depositors attempted to withdraw the entire amount, the officers of the bank decided it was better to request the Secretary of Banking to take over the bank and let all the depositors thereby benefit rather than preferring the three large depositors.

2. The decision of the Board of Tax Appeals as affirmed by the Circuit Court was not supported by substantial evidence.

There was some evidence to sustain the Board of Tax Appeals' decision, but the substantial evidence was in favor of the petitioners. The bank closed in October 1931, and a receiver was appointed. The evidence offered in behalf of the Commissioner was a photostatic copy of the order to liquidate made in December 1931 and the certificate of taking possession. The chief witness for the Commissioner was Dr. Sullivan who was the special deputy for the Secretary of Banking. He testified that the question of assets and liability was not definitely settled until the inventory and appraisement were filed in 1932 (Petitioners' Appendix, pp. 45, 46, and 47). From this it is apparent no one knew the true situation until 1932.

As against that evidence, the petitioners produced a number of witnesses, including the Secretary of Banking, who testified the bank was not insolvent. One of the witnesses, Mr. Conro, a vice-president of the bank, testified as to an appraisal made by the Pennsylvania State Department of Banking a few months before the bank closed. That appraisement showed a value of $6,500,000 giving the stock a book value of $21½ a share. There was also a great deal of evidence as to efforts being made to reopen the bank. All this, it is submitted, was sufficient to rebut the evidence

offered by the Commissioner as well as the presumption in favor of the Commissioner, especially in view of the decision in *B. F. Edwards v. Commissioner,* 39 B. T. A. 735. In that case the Board of Tax Appeals decided that the production of the book value of stock is sufficient evidence to shift the burden of proof to the Commissioner. Therefore, the burden of proof was actually on the Commissioner to establish the stock became worthless in 1931, not on the petitioners. In view of the evidence, the Commissioner did not substantially meet the burden of proof. Even if the presumption were still in favor of the Commissioner, and the burden was on the petitioners, the evidence shows the petitioners more than meet any presumption in favor of the Commissioner. The evidence was substantially in favor of the petitioners, not the Commissioner. Hence the Circuit Court of Appeals had the right to reverse the Board of Tax Appeals and erred in failing to do so.

Helvering v. Rankin, 295 U. S. 123, 131;
Helvering v. Tex-Penn Co., 300 U. S. 481, 491.

3. The decision of the Circuit Court is in conflict with decisions of the Board of Tax Appeals, Court of Claims and District Court.

The Board of Tax Appeals in *Wesley V. E. Terhune v. Commissioner,* 40 B. T. A. 750, held that the stockholder could not deduct a loss on the stock of a corporation until 1934 although a receiver had been appointed for the corporation on January 16, 1932. Yet the Board in the present case felt that one of the main reasons why the loss should be in 1931 was because the receiver had been appointed in 1931.

A case involving bank stock which was decided in favor of the taxpayer and was very similar to the case at bar is

John A. Watson, Jr. v. Commissioner, 38 B. T. A. 1026. This decision was acquiesced in by the Commissioner. In that case the petitioner invested in the capital stock of the Union Trust Company at Cleveland, Ohio, to the extent of $46,340. In 1934 he claimed on his income tax return that the stock was worthless. The Government disallowed this claim because it claimed that it should have been deducted in 1933. The Board found as a fact that in 1932-33 there were large withdrawals of cash and that a large amount of the liquidated assets was deposited with the Reconstruction Finance Corporation in 1933. After the banking holiday this particular bank did not reopen. On April 8, 1933, a conservator was appointed by Superintendent of Banks of Ohio. On June 15, 1933, the Superintendent took possession, appointing a Liquidator because the Superintendent of Banking felt that this institution was in an unsound and unsafe condition due to the frozen condition of its assets and not to insolvency. On June 15, 1933, the book value of the assets showed a margin over the liabilities of 25%. An appraisal was begun in July or August of 1933, but was abandoned. A later appraisal was started on January 3, 1934, and completed in July, 1934. On August 1, 1934, an assessment was made against the stockholders. Between the closing of the banking holiday and assessment against the stockholders there were numerous plans to reorganize and reopen the bank, all of which fell through. Now the Board of Tax Appeals in its opinion on page 1032 said:

> "To be deductible in 1934 this loss must be fixed by events which would satisfy neither 'an incorrigible optimist' nor a confirmed pessimist. Although these events need not be ascertained by the taxpayer to support a deductible loss . . . they must be such events as would clearly evidence to the person of average in-

telligence under the circumstances that no probability of realization of anything of value from this investment by sale, liquidation, or otherwise, thereafter existed . . ."

"Neither the appointment of a Conservator nor that of a Liquidator 'fixed' the loss here. Jarvis v. Heiner, 39 Fed. (2d) 361; Burnet v. Imperial Elevator Co., 66 Fed. (2d) 643; W. W. Hanly, 6 B. T. A. 613; Oscar K. Eysenbach, 10 B. T. A. 716. The bank was the largest in Cleveland. So far as was then known, it was solvent. The book value of its assets then exceeded its liabilities by a margin of about 25 per cent. Its only disclosed difficulty was the disproportionate depletion of its cash and liquid assets to other assets. Attempts at reorganization and reopening were continuing with the open encouragement of the state banking department. No assessment of the shareholders' liability was then made. Certainly, then, nothing happened in 1933, which eliminated the reasonable probability that petitioner would realize something from this stock, unless it was the 'interim report' of the Liquidator during the last day of that year."

In the *Watson* case there was no sales of the stock after the bank closed. This was also true of the Franklin Trust Company, and was another reason for the Board deciding against the taxpayer. But the Board in the *Watson* case on page 1034 said:

"Failure, as here, to show sales of this stock during 1933, undoubtedly tends to show absence of market value for this stock in that year. But we do not consider it decisive in the present circumstances, on the question of reasonableness of petitioner's hope of realizing from the liquidation of this stock at the end of that year."

The Court of Claims in *Bancroft v. U. S.*, 33 F. Supp. 225, held that stock did not become worthless in the year in which the bank closed. The court on p. 234 said:

> "The bank was closed not because it was insolvent, but because confidence in it had been impaired and because the deposits were constantly declining, culminating in a run on the bank for several days prior to its closing. No bank, of course, maintains its affairs in a sufficiently liquid state to pay all of its depositors at one time. For exactly this reason it was necessary for it to close its doors and liquidate its affairs gradually. There is nothing to indicate that such a gradual liquidation would not have produced amounts sufficient to return to the stockholders their investment or a substantial part thereof, except only the fact that no institution can realize from its assets as much as it can as a going concern. But while this made the value of the stock decline in value, it certainly did not make it worthless.
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> The mere closing of the doors of this bank did not make its stock worthless."

The facts in that case were very similar to those in the Franklin Trust Company. The Franklin Trust Company closed due to a lack of cash and the frozen condition of its assets. Plans were made to *reorganize and reopen* the bank, not just to liquidate it as in *Bancroft v. United States* (supra). Therefore, the closing of the Franklin Trust did not make the stock worthless at that time, especially since the bank closed voluntarily. All reasonable possibility to recover something on the stock did not disappear until all plans to reorganize and reopen had been abandoned which did not happen until after the appraisal was filed in 1932.

The Court of Claims has likewise ruled in *Lyon v. United States* (supra), that a loss on stock cannot be taken until it actually becomes worthless. Even the appointment of a receiver or a showing of bankruptcy is not sufficient to establish a loss, the court ruled. The receiver was appointed in 1925, yet the court held the loss did not occur until 1927.

The District of Arkansas in *Sherill v. Adkins*, 394 C. C. H. p. 9408, decided that certain bank stock became worthless in 1934. The bank was taken over for management by the Banking Commissioner in 1933. Notice of an assessment against the stockholders was sent out in 1933, but no steps taken to collect on the assessment until 1934. The court said:

> "It is true there is some evidence showing impairment of the stock in 1933, *but not to the extent that it was worthless* and it is evident that the Commissioner (Banking) himself had not come to that conclusion in 1933 and it is evident that he had come to the conclusion when the call on the stock of 1934 was made. I really think the taxpayer, as long as he or the Commissioner (Banking) had hopes of the bank paying out, would not be justified at that time, which would be in 1933, in asking a charge off in his income tax, and the proper time for this charge off would be in 1934."

In the present case both the decedent taxpayer, a member of the various committees trying to work out a plan to reopen the bank, and the banking department had high hopes all during 1931 that the bank would be reopened. It was not until after the appraisal was filed in 1932 at which time several Philadelphia banks suffered runs causing a generally upset condition, that the taxpayer gave up all hope of being able to realize anything on his stock.

Taxation is a matter of practical construction, especially as to losses. The courts have also held that a taxpayer is not entitled to deduct a loss for worthless stock until all reasonable possibility of getting something out of the stock has been destroyed (*Montgomery v. U. S.*, 23 Fed. Supp. 130). In view of the facts and circumstances surrounding the closing of the Franklin Trust Company, certainly the decedent taxpayer acted as a reasonable man. In view of all the efforts to reopen the bank in which the decedent taxpayer was very prominent, it cannot be said that all reasonable possibility of getting something out of the stock had disappeared until after the appraisal was filed in 1932.

4. The case of In re Hoffman, 16 Fed. Supp. 391, affirmed 87 Fed. 2d 200, was not the proper basis or authority for the Circuit Court's decision.

The *Hoffman* case arose out of a bankruptcy proceeding. The Commissioner claimed certain deficiencies in income tax for several years. The bankrupt attempted to set up a loss on Franklin Trust Company stock for the year 1932 and thus reduce the deficiency in income tax for that year. Several meetings of creditors were held. The testimony on the Franklin Trust Company phase of the *Hoffman* case was very meagre. Several employees of the banking department testified that the Department did not know what the relation of the assets and liabilities was until 1932 when the appraisal was filed. It was also brought out that a dividend was paid on the Franklin Trust Company stock on October 1, 1931 (p. 47, Transcript of Record in Circuit Court, No. 6157). The referee decided the loss occurred in 1932. The District Court reversed the referee on that and held the loss occurred in 1931 (*In re Hoffman*, 16 Fed. Supp.

391). This was affirmed in *Yocum v. Rothensies,* 87 Fed. 2d 200. The Circuit Court, it is true, upheld the decision that the loss was in 1931, not 1932, but the court added that the taxpayer had not charged the loss off, and therefore it could not be allowed. This, no doubt, was the real reason for the decision of the Circuit Court, because a loss, no matter when sustained, cannot be allowed unless it is charged off. Hence, it was not necessary for the Circuit Court to upset the decision of the District Court. The District Court reasoned it was more practical as a business matter to hold the stock became worthless when the bank closed. But that is not the correct test to establish a loss on worthless stock. The proper test is when has the stockholder lost all reasonable possibility of getting something out of the stock (*Montgomery v. U. S.,* supra). Furthermore, it is difficult to see how the stock could become worthless within a week after a dividend was paid. Hence, it is apparent that the District Court erred in the test it applied in the *Hoffman* case and the decision of the Circuit Court was not a precedent for the present case because in the *Hoffman* case the taxpayer has not charged off the loss.

In the case at bar, the decedent taxpayer charged off the loss in 1932. Moreover, the record is much fuller and more complete than in the *Hoffman* case. Your petitioners had many more witnesses and much stronger testimony. In *Bancroft v. Commissioner* (supra), the Court of Claims refused to follow the District Court of Massachusetts which had previously held that stock in a certain bank was worthless in 1932 when the bank closed. The Court of Claims in that case said (p. 233):

> "We are unable to agree with the District Court that this loss occurred in 1932. The record before that

court was by no means so full as the one before us. What its decision would have been had it had before it all the facts now presented is a matter of conjecture."

Therefore, the Circuit Court of Appeals erred in following the *Hoffman* case because the record now before the court is very complete whereas in the *Hoffman* case it was not and the testimony developed was very meagre.

5. Conclusion.

It has been shown that the loss on the stock involves a mixed question of law and fact because the effect of the closing of the bank and the filing of the appraisal is a matter of law and the Circuit Court of Appeals should have reversed the Board of Tax Appeals. It has also been shown that even if this is a question of fact only that there was no substantial evidence to support the Board of Tax Appeals' decision and the Circuit Court of Appeals should have reversed the Board of Tax Appeals. It has further been shown the decision of the Circuit Court of Appeals is contrary to the decisions of the Board of Tax Appeals, the Court of Claims and the District Court of Arkansas. It has further been shown that the Circuit Court of Appeals erred in following the *Hoffman* case.

It is therefore respectfully submitted that the writ of certiorari should be granted as prayed for, and the decision of the Circuit Court of Appeals should be reviewed.

Respectfully submitted,

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